

OFFSHORE HYPE: THREATS AND OPPORTUNITIES

The fear of relocations is not new. In 1993 already, Senator Arthuis report launched quite a wide debate in France on this topic. At the same time, economists confronted each other trying to quantify the effect of the competition of low-wage countries on unemployment or wage inequalities in wealthy countries, without reaching definitive conclusions, anyway. Periodically, concern breaks out again, especially when economic activity slows down, unemployment increases and the closing of industrial sites multiplies in favour of investments made in low-wage countries.



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COMPARISON OF HOURLY PAY (DOLLARS) IN THE US AND IN INDIA

ACTIVITY	HOURLY PAY (US)	HOURLY PAY (INDIA)
Call center	12.57	1
Medical files management	13.17	1.5 to 2
Paycheck management	15.17	1.5 to 2
Accounting	23.35	6 to 15
Financial analysis	33 to 35	6 to 15

Source: "The new wave of outsourcing", A.D. Bardhan & C. Kroll, 2003.

Among others, JVC, Continental, Alcatel, ST Microelectronics, Alstom, Cristalleries d'Arques closed factories in Europe to open other ones in distant countries. We can use the word "relocation" when, in order to meet the requirements of specific markets, a firm stops its investments in its original country to produce goods or services in a low-wage country. The aim is thus to take advantage of lower wage costs or more flexible labour laws. Such investments are often made within free zones, which are a kind of state within a state, dedicated to the import of semi-finished products which are re-exported, after a transforming process integrating a generally low share of added value. Thus, relocations now take place in fields which use a relatively important quantity of low-skilled manpower, often carrying out repetitive tasks. Leather, textile, clothing, toys, household appliances and "brown" products are nowadays almost totally relocated. Metal-lurgy, car industry and electronics are affected. But this trend also extends to services: call centres in Morocco or Senegal, computer services in India. They are thus oriented towards countries where wage costs are significantly lower. In 2003, the hourly cost of a worker amounted to 21 dollars in France or in the USA, 10 in Korea, about 2.5 in Brazil and in Mexico and, at last, 0.5 in Sri Lanka (source: US Bureau of Labor statistics).

Are these wages unfair? There is no obvious answer. Wages reflect the efficiency of an economic system. The lower work productivity is, the lower wages must be. And, undoubtedly, the Sri Lankan economy is not as efficient as US economy! If it is forty times less efficient, we cannot talk about "unfair" wages. Even if productivity in a Sri Lankan clothing business is only twice lower than in a French firm, the wages will nevertheless

be forty times lower because, at an equal skill level, there is no reason for paying different wages in the different sectors of economy. This is the law of comparative advantages. Developing countries take part in international trade only by specializing in activities where they are relatively less inefficient, like clothing in many developing countries. Relocations speed up this specialization process. But, as the economy is developing and becoming more efficient, the wage gaps are smaller. In 1975, the ratio between Korean wages and French wages was of 1 to 15, it is now of 1 to 2.

The fact that wage differences can be justified does not prove that they are justified in reality. How can one be certain that low wages only reflect differences in efficiency? The differences may have other origins. The first is the under-estimation of currencies which mechanically depreciate the international cost of work in the concerned country. But this effect does not concern only developing countries. The dollar depreciation also generates a decrease in US work cost compared with the work cost in the euro zone, which also involves countries linked with the dollar, like China. The second is the social "dumping" which enables the firms to put pressure on wages and pay their employees below the "normal" wages which would be justified by the economic situation of the country. Free zones, which rose from 79 to 3,000 between 1975 and 2000¹, are likely to favour this social dumping. The International Labour Organization (ILO/OIT) or the International Confederation of Free Trade Unions (ICFTU/CISL) thus reported cases when export free zones went against the national labour law or even infringed it with complete impunity². According to the ICFTU, this is effectively the case in Sri Lanka, but also in China, Mauritius or in Haïti. >>

THE OUTSOURCING OF IT SERVICES IN FRANCE (2002-2004)

	2002	2003	2004
French imports of subcontracted services	100 million €	200 million €	300 million €
Share of offshore in total computing IT market	1%	2%	3%
Man/year correspondance (French prices)	1,000	2,000	3,000
Man/year correspondance (Offshore prices)	2,000	4,000	6,000

Source: Cabinet Pierre Audoin Consultants.



Opposing to relocations would keep industrialized countries stuck in outdated specializations

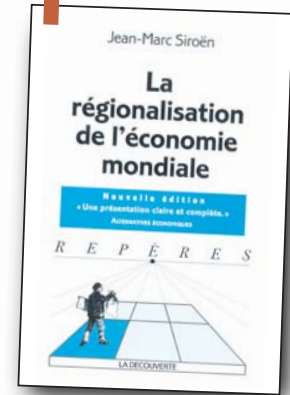
► If social dumping does exist, it cannot be the only reason for relocations

In industrialized countries, the firms are not helpless. Relocation has not only advantages. Physical distances, the ignorance of laws and local habits, unreliable infrastructures weigh on the advantage of low-wage countries. It takes one month for clothes made in China to reach France, which is sometimes a major inconvenience. In addition, wage costs often have little impact on the value of finished products. This value is transferred either upstream towards styling and design or downstream towards distribution. In these fields, industrialized countries remain competitive. The rise of quality level and very fine specializations can “save” sectors without future prospects. Are industrialized countries right when they worry about relocations? Laid-off employees and deserted regions are obviously the major losers, as a result of this trend. Competition with low-cost countries is weighing on the wages of less skilled workers and threaten their jobs.

Neither laid-off employees nor closed factories can be easily reconverted. But does it really mean that industrialized countries are losing? The answer is negative. First, relocation must enable to lower the price of concerned goods even if, in fact, the manpower cost often account for a low share of the product cost. This increase in purchasing power can then be transferred onto other products and boost the demand. Then, the growth of countries which take advantage of relocations enable to open markets for exporting firms. The impact may be direct when, for instance, the national firms export fibres or textile machines to relocated companies. It may be indirect if relocations favour development in the welcoming country and thus a demand for additional imports from industrialized countries.

However, the countries which lose the most jobs because of relocations are not necessarily those which will make the most of expanding markets. For instance, France surprisingly exports very little to China. Relocations cannot be prohibited. Anyway, industrialized countries cannot compete on wages which are so different from theirs. Opposing to relocations would keep industrialized countries stuck in outdated specializations, which would only delay the necessary adaptation and would deprive them of the opportunities offered by expanding markets. Of course, this move towards relocation and specialization requires adjustments, such as temporary protections, which are accepted by the OMC/WTO like the safety clause, provided that this temporary period enables to decrease the adjustment costs and even to restore the comparative advantage, as this was the case for car industry in the 70’s and 80’s. However, these adjustments should not be considered as permanent.

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In return, the social cost of relocations must be better shared out and, if necessary, should be borne by relocating companies. From a long term viewpoint, the winning industrialized countries will be the ones which will strengthen their competitiveness in the fields where demand is increasing. Such a demand will often be generated by countries which are today welcoming relocated activities. On an even longer term basis, industrialized countries will overcome the relocation challenge by improving the manpower quality, which is truly the best competitive advantage ever, the one which will enable the improvement of living standards in the former industrialized countries as well as in emerging countries. ■

¹ “Employment and social policy in exporting free zones”, ILO, Geneva, 2002.

² ILO: op.cit.: “The reverse side of brands”, ICFTU, December 2004.

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